



IN CASE YOU MISSED IT – September 2023

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Almost every day, federal and state courts issue opinions that affect taxpayers. The IRS and state taxing authorities also publish guidance on myriad topics.

Each month, this column will review a selection of recent court cases or guidance that tax professionals should know about when advising their clients and preparing tax returns.

For more extensive detail on any of these items, please feel free to reach out to the author.

[Palermo v. United States](#) – Importance of picking the right form when claiming a refund

This case was brought by the trustee of a Qualified Personal Residence Trust (“Trust”) on February 26, 2002. The decedent had transferred his home to the Trust for a five-year term. When the term expired in 2007, the decedent then leased the home for two subsequent one-year leases. In 2009, after the leases terminated, the decedent entered into a 99-year lease that would expire upon his death. Decedent died six years later, in 2015, and the 99-year lease terminated.

The Trust sold the home in 2016 for \$1,875,000 and reported that amount received on a Form 1041. The Trust claimed that it was entitled to a “stepped-up” basis of \$2,021,096 based on the fair market value of the property at the time of the decedent’s death and reported a capital loss of \$126,108 on the sale.

The IRS (Service) reviewed the Trust’s Form 1041 and determined that the Trust could not use the stepped-up basis calculation for determining gain or loss on the sale. A Notice of Deficiency was issued with a proposed assessment of \$930,127.90 of taxes, penalties, and interest. The Trust paid the assessment on September 24, 2021, and filed a Form 843, *Claim for Refund or Request for Abatement*. A lawsuit on the Form 843 was then brought in District Court in Florida requesting a federal income tax refund and a waiver of the penalty and interest.

The government moved to dismiss the case on the ground that the Court lacked subject matter jurisdiction. [Code section 7422\(f\)\(1\)](#) establishes a waiver by the United States of its sovereign immunity in order to allow taxpayers to file tax refund actions. [28 U.S.C. § 1346\(a\)\(1\)](#) grants district courts the jurisdiction over tax refund actions against the United States. In order to

proceed with a refund suit against the government, a taxpayer must first duly file a claim for refund or credit with the Service. [Code section 7422\(a\)](#). The regulations under [Code section 6402](#) provide that a claim for an income tax refund shall be made on the appropriate amended income tax return. [Treas. Reg. section 301.6402-3\(a\)\(4\)](#). The regulations specify that if a particular tax form is prescribed to claim a refund, then that form must be used. [Treas. Reg. section 301.6402-2\(c\)](#). If the taxpayer fails to file the refund claim on the proper form, then sovereign immunity will only be waived if the claim that was filed fulfills the elements of an informal claim; otherwise, the Court lacks jurisdiction to hear the case.

The taxpayer asserted that it did duly file an administrative claim for refund by filing the Form 843 and that the Trust has exhausted its administrative remedies. Alternatively, the taxpayer argued that if Form 843 was the incorrect form on which to claim the refund, it served as an informal claim sufficient to waive sovereign immunity.

The government argued that the filing of a Form 843 was insufficient as a formal refund claim because an amended Form 1041 should have been used to claim the refund. [Treas. Reg. section 301.6402-3\(a\)\(4\)](#) states that “[i]n the case of an overpayment of income taxes for a taxable year for which a form other than Form 1040, 1040A, or 1120 was filed [such as Form 1041 (U.S. Fiduciary Income Tax Return) or Form 990T (Exempt Organization Business Income Tax Return)], a claim for credit or refund shall be made on the appropriate amended income tax return.” This regulation specifically provides that in order to claim a refund on a Form 1041, an amended Form 1041 must be filed. Even the Form 843 instructions support the government's position that an amended Form 1041 is required to claim a refund of income taxes originally reported on Form 1041. The Form 843 instructions state, “[U]se Form 843 if your claim or request involves ... a refund of one of the taxes other than income taxes ...” Thus, the court concluded that the Form 843 was improper and taxpayer's argument that Form 843 was the correct form to claim a refund was incorrect.

The taxpayer also argued that the Form 843 served as an informal claim for refund. However, for an informal claim to be sufficient to waive sovereign immunity, courts have held that it must both put the Service on notice of the taxpayer's claims *and* must remedy the defects in the claim. The parties agreed that the taxpayer's claim might have been sufficient to have placed the Commissioner on notice, but because no subsequent amended Form 1041 was ever filed, the defects of the improper form that was originally filed were never remedied. Therefore, the Court held that it lacked jurisdiction and granted the government's Motion to Dismiss.

Takeaway:

Refund claims can be very complicated; there are numerous lawsuits every year examining whether the forms used to make the claims are properly completed or timely filed. It is worth the time to read and reread the instructions to make sure you do not lose a refund on a foot-fault.

[Notice 2023-59](#) – reminder of credit for Home Energy Audit

The Service recently issued guidance in Notice 2023-59 on the requirements to qualify for an Energy Efficient Home Improvement Credit under [Code section 25C](#) for expenditures on home

energy audits. The Service intends to issue proposed regulations on this topic that would apply to taxable years ending after December 31, 2022, but until those are issued, taxpayers and their advisors can rely on the advice in the Notice.

The intention of Code section 25C was to provide a tax credit for up to 30% of the amount spent by a taxpayer on the purchase and installation of certain energy efficient improvements in the taxpayer's principal residence. In its current iteration, it applies to property placed in service prior to January 1, 2033. There are three types of expenditures that qualify for the credit: (1) qualified energy efficiency improvements installed during the year, (2) residential energy property expenditures, and (3) home energy audits. The total cap for the 30% credit is \$1,200; however, within the \$1,200 limitation, there are additional limitations for specific expenditures. For example, only \$600 can be claimed for any item of qualified energy property; only \$600 can be claimed for exterior windows and skylights; only \$250 can be claimed for any single exterior door with a cap of \$500 in the aggregate for all exterior doors; and only \$150 can be claimed for home energy audits. (Note that the Code provides a separate credit and aggregate cap of \$2,000 for heat pumps, heat pump water heaters, biomass stoves, and biomass boilers.)

The Service issued Notice 2023-59 to provide further explanation for claiming the credit for expenditures for home energy audits. A home energy audit is an inspection and written report with respect to a dwelling unit located in the United States and owned or used by the taxpayer as the taxpayer's principal residence under [Code section 121](#). In order to qualify for the credit, the audit must both (1) identify the most significant and cost-effective energy efficiency improvements with respect to such dwelling unit, including an estimate of the energy and cost savings with respect to each such improvement, and like qualified appraisals, it must (2) be conducted and prepared by a home energy auditor that meets the certification or other requirements specified in regulations or other guidance promulgated by the Secretary. The Notice explained that the forthcoming proposed regulations would require the home energy auditor to provide the following information in the written report: (1) the Qualified Home Energy Auditor's name and EIN, (2) an attestation that the Qualified Home Energy Auditor is certified by a Qualified Certification Program, and (3) the name of such Qualified Certification Program. (The Notice did provide, however that if the taxpayer had a home energy audit conducted on or before December 31, 2023, the home energy auditor did not have to be a Qualified Home Energy Auditor as defined in the notice in order to claim the home energy audit credit.)

Code section 25C(b)(6)(A) limits the credit to a maximum of \$150, no matter how much more the taxpayer might have spent on the audit.

Additionally, the taxpayer must include with their tax returns "such information or documentation as the Secretary may require" to satisfy the substantiation requirement of Code section 25C(b)(6)(B).

The Notice explained that it anticipated that the forthcoming proposed regulations would allow taxpayers to satisfy the substantiation requirement of Code section 25C(b)(6)(B) by maintaining the written report signed by the Qualified Home Energy Auditor for as long as the general recordkeeping and retention requirements of [Code section 6001](#) and the regulations thereunder

require, and complying with any other instructions that might be set forth on Form 5695, Residential Energy Credits.

Takeaway:

Accountants should make sure questions about home energy improvements and home energy audits are on their tax organizers each year. For clients claiming the credit, they should make sure a qualified auditor was hired and the proper report was prepared and maintained. For those clients not claiming the credit, seeing this on an organizer might inspire them to look into this expenditure in the future. They currently have until 2033 to take action.

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